



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date:	06/25/12	Bill No:	Senate Bill 1015
Tax Program:	Sales and Use Special Taxes and Fees	Author:	Budget and Fiscal Review Committee
Sponsor:	BOE - FIRM Author - MTC	Code Sections:	RTC 19266 & 38001
Related Bills:	AB 1475 (Budget Comm.)	Effective Date:	Upon enactment

BILL SUMMARY

Among other things, this 2012-13 Budget trailer bill does the following:

- Authorizes the Board of Equalization (BOE) and the Employment Development Department to provide the Franchise Tax Board (FTB) with information relating to delinquent tax debtors, and allows that information to be used in the collection of delinquent amounts under the Financial Institution Record Match (FIRM) program administered by the FTB.
- Repeals existing law that adopted the Multistate Tax Compact. Enactment of the Multistate Tax Compact is required for full membership (referred to as "Compact" membership) in the Multistate Tax Commission.

ANALYSIS

Financial Institutions Record Match Revenue and Taxation Code Section 19266

CURRENT LAW

Current federal law (Sections 666 and 669A of Title 42 of the United States Code and Sections 466 and 469A of the Social Security Act) mandates the Financial Institution Data Match (FIDM) for the collection of delinquent child support debts. This process involves the matching of child support obligors with financial institution customer records in order to identify and levy the obligor's funds. The FTB is the agency in California responsible for collecting child support debts, as well as corporate franchise and state income taxes. Federal law currently prohibits the information received through FIDM to be used for any purpose other than child support collection, thereby making this potentially valuable collection resource unavailable for use in franchise and income tax collections by the FTB.

To allow use of this type of data in the collection of franchise and income tax debts, the Legislature recently passed a budget trailer bill, which the Governor signed on March 24, 2011 (SB 86, Ch. 14, Budget and Fiscal Review Committee). This bill, among other things, added Section 19266 to the Revenue and Taxation Code to require the FTB to coordinate with financial institutions doing business in this state to establish a financial institution record match system (FIRM) using automated data exchanges to the maximum extent feasible. The process will be very similar to the federal FIDM process described previously. However, since FIRM is a separate program, its use will not be

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restricted to child support collections but, rather, will apply to FTB's delinquent franchise and income taxes.

Section 19266 requires that, on a quarterly basis, financial institutions must provide the FTB with the name, record address and other addresses, social security number or other taxpayer identification number, and identifying information for each delinquent tax debtor as identified by the FTB who maintains an account at the financial institution as defined. Financial institutions may not disclose to the account holder, depositor, co-account holder, or co-depositor that their identifying information has been received and furnished to the FTB.

PROPOSED LAW

This bill amends Revenue and Taxation Code Section 19266 to require the BOE (as well as the Employment Development Department) to provide the FTB with information relating to delinquent tax debtors and to allow that information to be used in the collection of delinquent amounts under the FIRM program administered by the FTB.

Under this provision, the bill requires the BOE, on and after January 1, 2013, and on a quarterly basis thereafter, to provide its tax debtor information to the FTB in the format and manner specified by the FTB for inclusion in the FIRM.

The bill requires the FTB to include the delinquent tax debtor information provided by the BOE in its data file used to match delinquent tax debtor records to financial institution accountholder records, and it requires the FTB to provide the BOE with any matched record information.

The bill requires the BOE to reimburse the FTB for its costs related to implementation and administration of these provisions.

BACKGROUND

The FIRM record match for FTB will begin in Fiscal Year 12/13 and will be an automated process that will allow FTB to identify assets and issue levies in greater numbers than in prior years. This next fiscal year, FTB expects to issue more than 475,000 levies, an increase of approximately 75 percent over last year.

California's tax system is one based on the principal of voluntary compliance. Most taxpayers that report their tax and fee liabilities to the BOE are honest and generally comply with the tax laws. However, the BOE's number of taxpayers with overdue accounts receivables, as well as the overall balance, continues to increase - further complicating the state's budget woes. The BOE's accounts receivable balances for unpaid *final* liabilities (liabilities that are due and not under appeal) amount to over \$1.6 billion.

Recent economic turmoil is one factor contributing to this increase. However, other reasons include the fact that some businesses purposefully fail to remit the tax, such as when a taxpayer diverts the sales tax reimbursement collected from a customer for his or her own purposes instead of remitting the tax to the State. Those businesses that fail to pay their tax liabilities have in many cases an unfair competitive advantage over taxpayers who comply with the law and pay their fair share.

In general, the tools the BOE has in current law to provide incentives for taxpayers to timely pay their tax and fee liabilities and to assist the BOE in collecting delinquent tax or fee liabilities include:

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- The imposition of penalties and interest on the amount of the late tax or fee payment.
- The authority for the BOE to revoke a taxpayer's seller's permit for failure to pay outstanding sales and use tax liabilities.
- The opportunity for taxpayers to enter into affordable installment payment plans.
- The authority for the BOE to issue a Notice of Levy (NOL) to any third-person in possession of funds or properties belonging to the debtor, such as bank accounts, rental income, or accounts receivables, which, in turn, requires that third person to submit to the BOE all the debtor's cash or cash equivalents that would satisfy the NOL.
- The authority for the BOE to use Earnings Withholding Orders (EWO) to collect delinquent tax liabilities for which a state tax lien is in effect. An EWO is a continuing wage garnishment based on a percentage of a debtor's earnings, not to exceed 25 percent of disposable income. The EWO remains in effect until the total amount owing has been paid, or the order has been withdrawn.
- The authority for the BOE to issue a warrant to seize property and convert it to cash to satisfy a debt. Warrants are enforced by a marshal. "Till-tap" or "keeper" warrants are warrants served by the California Highway Patrol or the local sheriff that allow them to enter a tax debtor's business and take possession of personal property or collect the contents of the cash registers.
- In addition to the preceding, a statutory tax lien automatically arises by operation of law, which is a claim upon real and personal property for the satisfaction of a tax debt. The lien is in force for 10 years, unless the liability becomes satisfied or a Notice of State Tax Lien is recorded with a county recorder's office or the Secretary of State. The recording of the notice provides notice to all parties of the debt against real and personal property belonging to the tax debtor and located in the California county where recorded.

COMMENTS

This provision is sponsored by the BOE. Because of the budget crisis, key public services are facing potential cuts. The BOE is able to do a better job of collecting delinquent liabilities by employing modern collection techniques and information technology. Implementing FIRM would accomplish this by requiring financial institutions to match its customer records against the BOE's database of individuals with final liabilities. Most of the revenue collected by the BOE is remitted voluntarily; however, enforced collection actions, such as notices of levy sent to the tax debtors' banks, are required when efforts to gain voluntary compliance from taxpayers have been exhausted.

If the BOE were to be included in FTB's FIRM processes, the result would be more efficient collections of delinquent liabilities. BOE staff would have accurate "real-time" financial information, which would stop the BOE from sending levy notices to incorrect financial institutions. Also, BOE staff time spent in researching tax debtors' banking information would be reduced.

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Multistate Tax Compact*Part 18 (commencing with Section 38001) of the Revenue and Taxation Code***CURRENT LAW**

Under existing law, the “Multistate Tax Compact” has been created for purposes of (1) facilitating proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes, (2) promoting uniformity or compatibility in significant components of tax systems, (3) facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration, and (4) avoiding duplicative taxation.

Under the provisions of the Multistate Tax Compact, the Multistate Tax Commission is required to administer the Compact, and the executive officers of the Franchise Tax Board and the Board of Equalization are required to serve as California’s representative on that Commission, alternating annually.

PROPOSED LAW

This bill repeals Part 18 (commencing with Section 38001) of the Revenue and Taxation Code that adopted the Multistate Tax Compact, thereby allowing California to withdraw its membership in the Multistate Tax Commission.

BACKGROUND

The Multistate Tax Commission was created by an interstate compact in 1967, and California became a member on January 1, 1976. The Multistate Tax Commission is an organization of state governments that is designed to work with taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. The Commission is designed to:

- encourage tax practices that reduce administrative costs for taxpayers and States alike,
- develop and recommend uniform laws and regulations that promote proper state taxation of multistate and multinational enterprises,
- encourage business compliance with state tax laws through education, negotiation and enforcement, and
- protect state fiscal authority in Congress and the courts

Twenty states, including California, participate as Compact members, six states participate as sovereignty members, and 22 states are associate or project members.

The Compact provides that the Multistate Tax Commission’s budget be apportioned among the member States as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each member State and its subdivisions from income taxes, gross receipts taxes, and sales and use taxes. California’s dues for both the Board of Equalization and the Franchise Tax Board are approximately \$540,000 annually.

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COMMENTS

This provision is sponsored by the author and is intended to address a concern related to a potential risk of state revenues of \$500 million related to a case soon to be decided by the California Court of Appeals. In that case, the taxpayer is arguing that the language adopted by the Legislature in 1993 (to bring about double-weighting of sales for California income tax purposes) was legally ineffective in regard to overcoming one particular aspect of the MTC. If the taxpayer is ultimately judged to be correct, the author believes that the correct way to overcome that aspect of the MTC is to repeal the Compact. Not adopting this legislation, in the case that the taxpayer wins in court, would cost the state about \$150 million per year ongoing, and more than \$500 million for open years.

This provision would have little impact on the BOE's tax administration. The primary benefit that the MTC offers to the BOE is the "nexus leads." These are MTC-generated inquiries that indicate that a particular out-of-state business may have California nexus and may be required to collect California use tax on their sales to California consumers. From 2009 through today, the BOE has received a total of 10 leads from MTC, 4 of which are currently under investigation. Of the MTC leads in 2009 and 2010, the BOE has received over \$90,000 in use tax revenue.

While the repeal of the Multistate Tax Compact would withdraw California from Compact membership, the BOE would continue having the option of engaging on a contractual basis in any of the MTC special programs, such as the nexus lead program described in the previous paragraph.

Related Legislation. AB 1475 (Budget Committee) contains similar provisions.

COST ESTIMATE

The BOE would incur some administrative costs related to the FIRM provision. These costs are estimated to be \$523,000 in FY 2012-13 and \$345,000 ongoing.

As an MTC Compact member, California's dues are shared with the FTB. BOE's share of the costs for fiscal year 2011-12 amounted to \$270,000. These dues would no longer be required if this bill becomes law. If, however, California decides that it wants any of the services that the MTC provides, it may acquire them on a "fee-for-service" basis, as some states currently do.

REVENUE ESTIMATE

- **Financial Institutions Record Match.** When fully implemented, this bill would result in increased collections of \$12.3 million annually, primarily from state and local sales and use tax liabilities. The additional revenue would be derived from greater timeliness in sending notices of levy to banks with accounts held by tax debtors discovered through FIRM and from efficiencies gained by reducing the search time for the collection of assets.
- **MTC.** We don't anticipate a measurable impact to state or local revenues, considering that California could contract with MTC for any services it believes would be beneficial.

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